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SUBJECT: CROATIAN UNEMPLOYMENT DOWN BUT STILL HIGH

¶1. SUMMARY: Despite a steady decline in recent years, the Croatian unemployment rate remains high, at 11.8%. One contributing factor is a mismatch between the skills job-seekers have and those employers want. The mismatch stems from two situations: students are pursuing the "wrong" majors, and workers let go from industrial jobs do not have the skills for new jobs. An active (though decreasing) grey economy also dampens regular employment levels, though no one knows its exact extent. Labor market rigidity, largely due to stringent employment protection legislation, is a third and often cited factor. Together, these factors have given Croatia one of the lowest rates of labor market participation in Europe and act as a brake on economic growth. End summary.

Too Many Unemployed: Too Inexperienced,
Too Uneducated, and for Too Long

¶2. Although unemployment in Croatia has declined steadily over the past several years, its current level of 11.8% is high enough to be a concern for government and citizens alike. Data from the Croatian Bureau of Statistics indicate some dimensions of the problem. Youth are hardest hit. The unemployment rate among 15- to 24-year-olds is about 29%, compared with an EU rate of 17% for the same age group, and about a quarter of all unemployed Croatians fall in the age range of 15 to 24. Many of the unemployed (42%) have been seeking a job for more than two years. The majority (63%) have no more than eight years of education. [Note: This figure presumably includes many older people. However, the GOC recently passed a law making secondary school mandatory.]

¶3. To get a fuller picture of the situation, we spoke with trade union, employers association, and employment service representatives, as well as researchers at the Institute of Economics, Zagreb (EIZ).

They Don't Want the Skills We Have,
And We Don't Have the Skills They Want

¶4. While only the Croatian Employers Association representative stressed the need for economic growth to spur job creation, everyone with whom we spoke pointed out an apparent mismatch of the skills employers seek and the skills the unemployed have. One aspect of the problem is that many younger Croatians are pursuing social sciences, with economics the most popular major. Correspondingly, enrollment in technical sciences has dropped. Mario Svirgic, chief economist at the Union of Autonomous Trade Unions of Croatia (UATUC), told us this focus on social sciences is partly a hold-over response to the need for people with training in economics, political science, and journalism to build Croatia as an independent nation. The supply of such people now, however, exceeds the need. Maja Vehovec, senior research fellow at the EIZ, Zagreb, noted that it is cheaper for universities to offer--and cheaper and easier for students to pursue--social science courses than technical science courses. She

also said there is a shortage of technical science teachers.

15. In September, Martina Dalic, State Secretary for Development Strategy and Coordination of EU Funds, told us that the mismatch of education and industry contributes to unemployment. She said the government has identified education as a key long-term input to its development strategy, but it will not identify particular sectors as priorities. Instead, the government aims to provide the conditions for a strong education system (i.e., human capital and infrastructure) while leaving the choice of priority sectors to the entrepreneurs.

16. The second aspect of the skills mismatch is a consequence of economic restructuring. From 1987 to 2005, the number of industrial workers in Croatia decreased by 300,800. As in other countries, many of these workers have not been able to find new jobs using skills from their former jobs. Representatives from both the UATUC and the Independent Trade Unions of Croatia (ITU) told us that employers do not invest enough in their employees. Bernard Jakelic, deputy general director of the Croatian Employers Association, agreed that some employers do not understand the value of investing in their employees, but they are those who lack managerial skills and operate from an "old mentality." In contrast to the union representatives, he added that the economy needs further liberalization and more government support for research and development.

The Grey Economy Tempts Us All

17. Although the methodology used to calculate the unemployment rate includes an estimate of unofficial labor, it is difficult to estimate the full size of the grey economy and the extent to which it lowers employment levels in the regular economy. The people with whom we spoke believe the grey economy has shrunk over the last several years and that the decrease is due more to the growth of the regular economy than to government efforts. Valerija Botric, a

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research associate at the EIZ, explained that Croatia's grey economy includes two kinds of workers. The first type is "unemployed" people who work unofficially. Aided by Croatia's tradition of supporting family members, some in this group choose to live with their parents or other relatives and work undeclared jobs to get by rather than relocate or accept a regular job below their desired wage.

18. The second type of grey-economy workers is those who have regular jobs but work undeclared overtime, have cash jobs on the side, or receive cash wages in addition to their declared wages. According to Kresimir Sever, president of the ITU, high tax, health and pension obligations are a significant factor prompting employers to offer workers undeclared overtime or schemes of a declared wage plus cash. Workers accept these opportunities because they value the immediate cash benefit over the potential future pension benefits they forfeit. Mr. Sever acknowledged the difficulties the government faces in trying to reduce tax, health or pension obligations. He said, however, that these arrangements of declared and cash wages will likely continue to decrease in prevalence as smaller businesses are replaced by bigger companies for whom the hassle and risks of such schemes outweigh the financial savings.

If We Can't Fire, We Won't Hire

19. In 2003, the World Bank identified stringent employment protection legislation as the key labor market institution behind low job creation and high unemployment in Croatia. That same year, Croatia enacted legislation that made it easier and less costly to fire and hire workers. The law reduced the severance pay requirement to six pay periods and shortened the required notice period. It also extended the maximum length of fixed-term contracts from one to three years and eased the provisions for when employers could use such contracts. A result of the law--and an indication of employers' desire for more flexibility-- is that 85% of new contracts are fixed-term. Despite these changes, however, the World Bank and others continue to cite labor market rigidity as a primary hindrance to employment growth and business competitiveness for Croatia. A new

labor law is expected next year. The UATUC will seek extension of notice period requirements and a cap or other provisions to reduce the number of fixed-term contracts. In contrast, the Croatian Employers Association will seek changes to make it yet easier both to fire and to hire workers.

Comment

¶10. The steady fall in unemployment in Croatia is a good sign of the country's economic growth. Although there is no indication that the trend will stop or reverse in the near future, it remains to be seen how far unemployment can decrease before reaching the structural level. If and when unemployment begins to approach the structural level, one factor the GOC will need to consider is how to increase Croatia's very low labor market participation rate of 48.2%. To date, the GOC has focused little effort on improving this rate. The 63% of unemployed persons with no more than an elementary education may be largely unemployable in the modern economy. The GOC and business groups talk frequently about the need for Croatia to move into a "knowledge economy" to secure future growth. However, continued subsidies for failing industries such as shipbuilding and textiles divert resources and crowd out more productive state investment. In the end, it may require a generational change before Croatia makes substantial gains in employment. End comment.

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